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In The
Supreme Court of the United States

OCTOBER TERM, 2000

WAYNE I. ELLIOTT, FRANCIS MARITOTE,
J. BRIAN SCHAER, AND JONATHAN A. SION,
Petitioners,

v.

COMMODITY FUTURES TRADING COMMISSION,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Seventh Circuit Court of Appeals' Panel Opinion in *Elliott v. Commodity Futures Trading Commission* imposing liability on the four petitioner commodity traders for alleged commodities violations under the Commodity Exchange Act conflicts with the United States Supreme Court's decision in *Allentown Mack Sales & Service, Inc. v. National Labor Relations Board* by giving improper deference to the findings and conclusions of the Commodity Futures Trading Commission under the substantial weight of the evidence test of the Administrative Procedure Act?

2. Whether the Seventh Circuit's Panel Opinion in *Elliott* conflicts with the Second Circuit's Opinion in *Stoller v. Commodity Future Trading Commission* (rejecting trader liability) because the Commission failed to promulgate rules regarding the legitimate commodities trading practice at issue known as "freshening," thereby creating uncertainty in the commodity futures markets, an integral part of this country's economy?

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Wayne I Elliott, Francis Maritote, J. Brian Schaer and Jonathan Sion respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above entitled proceedings on February 3, 2000.

OPINIONS BELOW

The denial of the Petition for Rehearing *En Banc* (Judges Easterbrook, Posner, and Manion dissenting) is reprinted at Appendix A hereto ("App. A"). The 2-1 opinion of the United States Court of Appeals for the Seventh Circuit (Judge Easterbrook dissenting) is reported at *Elliott v. Commodity Futures Trading Commission*, 202 F.3d 926 (7th Cir. 2000), and is reprinted at Appendix B hereto ("App. B"). The opinion and order of the Commodity Futures Trading Commission (Commissioner Tull dissenting) is reported at *In re Elliott*, Comm. Fut. L. Rep. (CCH) ¶ 27,243 (CFTC Feb. 3, 1998), and is reprinted at Appendix C hereto ("App. C"). The decision of the Administrative Law Judge (Painter) is reported at *In re Elliott*, Comm. Fut. L. Rep. (CCH) ¶ 26,789 (CFTC Sept. 11, 1996), and is reprinted at Appendix D hereto ("App. D").

JURISDICTION

The Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1). The Petitioners seek review of the decision of the United States Court of Appeals for the Seventh Circuit issued on February 3, 2000. A petition for Rehearing with Suggestion for Rehearing *En Banc* was denied on May 11, 2000 in a 8-3 vote, with Judges Easterbrook, Posner and Manion dissenting. This Petition is filed within 90 days of the denial of the Petition for Rehearing.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

Sections 4c(a)(A) and (B) of the Commodity Exchange Act, 7 U.S.C. § 6c(a)(A) and (B), provide:

> (a) It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof --
>
> > (A) if such transaction is of the character of, or is commonly known to the trade as, a "wash sale," "cross trade," or "accommodation trade," or is a fictitious sale; or
> >
> > (B) if such transaction is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.

Section 1.38(a) of the Commission Regulations, 17 C.F.R. § 1.38(a), provides:

> (a) Competitive execution required; exceptions. All purchases and sales of any commodity for future delivery, and of any commodity option, on or subject to the rules of a contract market shall be executed openly and competitively by open outcry of posting of bids and offers or by other equally open and competitive methods, in the trading pit or ring or similar place provided by the contract market,

> during the regular hours prescribed by the contract market for trading in such commodity of commodity option: Provided, however, that this requirement shall not apply to transactions which are executed non-competitively in accordance with written rules of the contract market which have been submitted to and approved by the Commission, specifically providing for the non-competitive execution of such transactions.

Section 9.33(c)(3) of the Commission Regulations, 17 C.F.R. § 9.33(c)(3), provides, in relevant part:

> (c) Standards of review. In reviewing an exchange disciplinary, access denial or other adverse action, the Commission will consider whether:
>
> * * *
>
> (3)(i) In the case of a disciplinary action, the record contains substantial evidence of a violation of the rules of the exchange, or (ii) in the case of an access denial or other adverse action, the record contains substantial evidence supporting the exchange action.

Section 556(d) of the Administrative Procedure Act, 5 U.S.C. § 556(d), provides, in relevant part:

> (d) Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance

with the reliable, probative, and substantial evidence.

Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706, provides, in relevant part:

> To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall --
>
> (1) compel agency action unlawfully withheld or unreasonably delayed; and
>
> (2) hold unlawful and set aside agency actions, findings, and conclusions found to be --
>
> * * *
>
> (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute[.]
>
> In making the foregoing determination, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

STATEMENT OF THE CASE

This case is one of national importance which involves the deference given to a decision of an administrative agency and the financial impact of that deference on a key segment of this country's economy -- the commodity futures markets. In particular, this case involves a decision of the Commodity Futures Trading Commission wherein the Commission -- without following the rulemaking requirements of the Administrative Procedure Act as mandated by the Second Circuit and without according the proper deference to the decision of the administrative law judge -- sets forth a new rule which effectively bans retroactively a legitimate trading practice and creates a chilling effect on the commodity markets.

This case arises from a divided Commission opinion, which reversed the findings of an administrative law judge (App. C), and a divided opinion of the Seventh Circuit Court of Appeals (the "Panel Opinion"), which affirmed the Commission's Opinion (App. B). In affirming the Commission's opinion, the Seventh Circuit opinion conflicts with the United States Supreme Court's decision in *Allentown Mack Sales & Service, Inc. v. National Labor Relations Board,* by giving improper deference to the findings and conclusion of the Commodity Futures Trading Commission (the "Commission" or "CFTC") under the substantial weight of the evidence test of the Administrative Procedure Act. The Seventh Circuit's opinion also creates a conflict of law between the two circuits that decide the overwhelming majority of significant commodity cases -- the Second and Seventh Circuits. The Seventh Circuit's opinion in *Elliott* reached a conclusion different than that of the Second Circuit's in *Stoller v. Commodity Future Trading Commission,* 202 F.3d 426 (7th Cir. 2000), 834 F.2d 262 (2d Cir. 1987) (reprinted at Appendix E hereto ("App.

E")), both of which were based upon the same legitimate trading practice. In *Elliott*, based solely on faulty and unsupported inferences, the Seventh Circuit affirmed the Commission's reversal of an administrative law judge and found Petitioners, four reputable members of the Chicago Board of Trade, guilty of prearranged and wash trading. (App. B).

A. Evidence Presented At The Hearing And The Commission's Conclusion

The facts of this case, as opposed to the inferences and conclusions therefrom, are not in dispute and can be culled from both the majority and dissent in the Seventh Circuit's opinion. The Division of Enforcement of the Commission (the Commission's enforcement arm) charged the four petitioner commodity traders with certain commodity future trading violations (App. B at 2b), at the Chicago Board of Trade (the "CBOT"), the nation's largest commodity exchange. Specifically, the Division alleged that during February - March 1991, Petitioners engaged in 32 noncompetitive, non-bona fide wash trades in violation of sections 4c(a)(A) and 4c(a)(B) of the Commodity Exchange Act (the "Act") and section 1.38(a) of the Commission's regulations. 7 U.S.C. §§ 6c(a)(A), (B); 17 C.F.R. § 1.38(a). (*Id.*). After a four day hearing, all of the charges against Petitioners were dismissed, but the Commission reversed that decision and imposed a suspension of six months and a $50,000 fine on each Petitioner. (App. C). (By the Seventh Circuit's Order of June 14, 2000, those penalties have been stayed.). A more full review of the record follows.

In 1991, Petitioners were members of, and registered floor traders at the CBOT. (App. B at 3b). Petitioners were all experienced commodity traders who remained active in trading wheat contract futures in the "delivery

months," i.e., the months of March, May, July, September, and December when the commodity must be delivered. (*Id.*). At a hearing before an administrative law judge (the "ALJ") in December 1995, the Division presented in its case-in-chief, the testimony of only one witness, Hugh Rooney ("Rooney"), the Division's investigator and expert, in the form of a written report. (*Id.* at 2b). Rooney's report explained the trading strategy at issue in this case, a strategy commonly called "freshening," which the Commission admitted was a legitimate trading practice:

> [W]heat contracts are delivered in March, May, July and September. Trading during these delivery months is considerably more risky than during non-delivery months. Contract delivery on the CBOT is on a "first-in-first-out" basis: those traders with the oldest contracts are at the front of the delivery line; those with newer contracts are at the back. Traders can reposition themselves in the delivery line (a practice called "freshening") by liquidating old open positions in the nearby delivery month and buying equivalent volume contracts for future delivery (called the deferred month). As a trader's delivery date nears, the price differential between the contracts on the deferred months and those on the nearby month narrows. The longer a trader waits to freshen his position, the greater the potential profit. If he fails to successfully freshen, however, he risks arrival at the front of the line where he will be forced to accept delivery and pay the carrying charges for storing and insuring the grain. Because of these risks, only some of the 75 to 100 wheat futures traders remain active during the wheat delivery months.

(App. B at 3b-4b) (footnote omitted).

The 32 subject trades among the Petitioners occurred during an eight day period in February - March 1991. (App. at 4b). On different days, different Petitioners sold and repurchased the same "spreads" in identical quantities at the same price. (*Id.* at 4b-6b). The trades exhibited certain symmetrical and circular characteristics. (*Id.*).

As the Panel Opinion stated: "[T]his was the Division's substantive case against the [P]etitioners. . . . The Division presented no direct evidence that the [P]etitioners had prearranged or non-competitively executed any of the trades. (App. B at 6b). The evidence was entirely circumstantial." (*Id.*). Rooney concluded that Petitioners had engaged in a prearranged trading scheme by executing illegal wash trades to "avoid, decrease and/or delay delivery" of the wheat. (*Id.*). Rooney relied on the following "characteristics" of the subject trades to support this conclusion: the size of the trades were very large; none of the trades recorded a profit or loss; no other traders were involved in the subject trades; the trades exhibited a circular pattern between and among three or four of Petitioners; some of the trades were accompanied by recordation errors on Petitioners' trading cards; and Petitioners were all similarly motivated to freshen their positions. (*Id.* at 6b-8b).

In the Petitioners' case-in-chief, Petitioners established that they were all experienced high-volume traders in wheat futures each trading for his own account. (App. B at 3b). Petitioners all testified under oath that the trades were competitively executed by "open outcry," i.e., the public offer to sell in front of willing commodity buyers. (*Id.* at 8b, 29b). Petitioners presented character witnesses, who vouched for their reputations as honest traders with high integrity. (*Id.* at 8b, 29b, 32b). In fact, the Division stipulated that the Petitioners "have high integrity and honest reputations as traders." (*Id.*). Accordingly, the ALJ ruled

that all of the Petitioners were credible. (*Id.* at 29b). Petitioners also presented testimony from other traders that the trades at issue were executed by open outcry and that other traders could have participated in the subject trades had they so chose. (*Id.*). The ALJ also found this testimony to be credible. (*Id.*). Three other long-time traders testified that the circular pattern of trading exhibited by the subject trades was common in the closing month of a futures contract. (*Id.* at 32b). Finally, Petitioners presented testimony that the recordation errors on their trading cards were common and not unusual. (*Id.* at 32b-33b).

In addition to the witnesses presented, Petitioners also effectively and vigorously cross-examined Rooney. (App. B at 9b). Under cross-examination, Rooney acknowledged that his report was founded on limited information: he did not interview any other traders to determine whether the trades had been executed by open outcry; he had not conducted any analysis to determine whether lack of profit or loss was unusual during delivery months; it was impossible to know how many traders could have participated in the subject trades or if any of them wanted to; he had only used the eight days of the subject trades as his entire sample for his analysis of typical delivery-period trading; and it was impossible to quantify the likelihood of the recordation errors of the subject trades. (*Id.* at 9b-10b). Rooney also revealed that the statistical and factual bases for his conclusions were based on computerized CBOT records which had not been produced to Petitioners. (*Id.* at 10b).

At the close of the evidence, the ALJ dismissed the charges against Petitioners. (App. B at 11b); (App. D). The ALJ found Petitioners to be credible and determined that all of the trades had been executed by open outcry. (App. at 9d). He further found that market conditions and

the motivation of freshening explained the limited participation during the delivery cycle. (App. B at 11b); (App. D at 9d).

On appeal to the CFTC, the Commission, in a 3-1 vote, reversed the ALJ, thereby discounting Petitioners' sworn testimony and relying, instead, upon the precision and symmetry of the subject trades to conclude that Petitioners prearranged their trades, executed wash trades, and caused non-bona fide prices to be recorded. (App. B at 11b); (App. C at 16c-21c).

In his dissent, Commissioner Tull emphasized that this case was based solely on circumstantial evidence and that he was not persuaded by the Division's evidence of the alleged violations. (App. C at 27c). He further emphasized that historically, the CFTC acknowledged that "'experienced professionals in the customs of the pit [where the trading takes place], the members of . . . [a certain commodity committee] are in the best position to draw inferences from evidence presented to them.'" (App. C at 27c-28c). Finally, Commissioner Tull highlighted the differences between himself and the other Commissioners of the CFTC: "As a former trader myself, I believe that I am uniquely qualified among my fellow Commissioners to interpret the implications and inferences of the trading activity that lie at the heart of this case." (*Id.* at 28c). He chided the other Commissioners for "second guessing" the activities and intentions of the Petitioners and ignoring the findings of the ALJ. Accordingly, he concluded that "freshening occurred by lawful means." (*Id.* at 28c-28d).

B. The Seventh Circuit's Panel Opinion

Upon review, the Seventh Circuit, in a 2-1 Panel Opinion (with Judges Cudahy and Ripple) affirmed the Commission's Opinion, stating "the Commission is pre-

sumptively better able to weigh the relative strengths of the competing inferences and . . . its conclusion is reasonable." (App. B at 2b). Judge Easterbrook dissented from the Panel Opinion. The Panel recognized that the Commission's entire case rested upon circumstantial evidence of the pattern of trading and recordation mistakes and the conclusions drawn by Rooney in interpreting that evidence. (App. B at 14b-16b). The Panel, however, believed that it must defer to the Commission's conclusions because "whether a particular set of circumstances supports an inference of non-competitive trading on the futures markets is an issue peculiarly within the Commission's area of expertise." (*Id.* at 14b).

The Panel Opinion analyzed the testimony of the Rooney and found that it was significantly flawed and unreliable. Specifically, the Panel made the following observations:

> The Division, through Hugh Rooney presented what was essentially a "numbers" case: the circumstances surrounding the charged trades, it alleged, were statistically improbable. But it provided no reliable statistics to support this charge (and, indeed, could not even produce for the petitioners some of the raw numbers upon which it allegedly relied). It conducted no analysis of the liquidity of the market or of the usual number of traders swapping spreads during wheat delivery cycles; no analysis of the likelihood that delivery cycle freshening trades would result in no profit for the traders; and no analysis of the likelihood of making mistakes on trading cards or other audit trail irregularities -- that is, it failed to justify Rooney's assertion that the "significant characteristics" were at all significant.

(App. B. at 16b-17b). Notwithstanding the flaws in the basis for the expert testimony, the Panel believed that the ALJ and the Commission did not rely upon Rooney's testimony, assigning it "little if any weight." (*Id.* at 18b). According to the Panel Opinion, "Both the ALJ and the Commission complied with this principle, ignored Rooney's unreliable opinion and [drew] their own inferences from the undisputed facts." (*Id.* at 18b-19b). The Panel then stated: "We recognize the seeming illogic of rejecting (to the extent we do) Rooney's inference on the one hand, . . . while endorsing (also to the extent we do) the Commission's on the other." (*Id.* at 19b). The Panel believed that the Commission drew a distinction between the expert's factual and opinion testimony and "simply drew its own inferences [albeit the same as the expert's and for the same reasons] from the undisputed accounts of the trades, focusing on the trading symmetries which it thought were indicative of non-competitive and pre-arranged trading." (*Id.* at 18b). According to the Panel, it should affirm the CFTC's decision since this pattern swayed the Commission. (*Id.* at 18b). Accordingly, the Panel deferred to the Commission in part because of its "expertise" or perhaps more precisely, as the dissent would have it, its specialized knowledge." (*Id.* at 20b).

C. Judge Easterbrook's Dissent

In his dissent, Justice Easterbrook chided the majority for affirming what, in his opinion, was a flawed and baseless decision. (App. B at 27b). Judge Easterbrook stated, as the Panel and Commission had, that the trading practice of delaying delivery is a legitimate trading practice that adds needed liquidity to the market. (*Id.*). He further stated that approximately 13 years ago, the Commission concluded that this trading practice was illegal but its decision was reversed by the Second Circuit in *Stoller v. CFTC*,

834 F.2d 262 (2d Cir. 1987). (*Id.* at 28b). In *Stoller*, the Second Circuit held that if the Commission wished to make this type of trading illegal, it was required to promulgate a rule defining what practices were forbidden. (*Id.*). Notwithstanding *Stoller*, the Commission again found a trading practice identical to that in *Stoller* to be illegal and indicative of prearranged and wash trading. (*Id.*).

Judge Easterbrook also agreed with the majority that the Division's expert's testimony was "junk science" and unreliable, with no probative value. (App. B at 29b). Without Rooney's testimony, no evidence exists to support the Panel's opinion or the Commission's conclusions. (*Id.*).

Judge Easterbrook disputed the Panel's "deference" to the Commission's purported "expertise": (App. B at 29b). "Unless we are to abandon all judicial review of administrative orders, however, we cannot kowtow to a claim of expertise; the claim must be supported by evidence and reasoning." (*Id.*). He pointed out that none of the Commissioners were trained in statistical analysis or game theory, or had experience in industrial organizations, or as a financial economist. (*Id.* at 30b). In fact, the backgrounds of the Commissioners, other than Commissioner Tull, were a lawyer, banker, and a manager of an agricultural conservation program. (*Id.*). Judge Easterbrook stressed:

> Courts accept agencies' decisions to the extent that Congress has delegated authority to them, not because their decisions may be supported by unspoken reasoning *that is too sophisticated to be explained to mere judges.* Delegation entails the power to make policy choices. . . . . What the CFTC has done here does not amount to a reasoned policy choice. *Challenged by Stoller to draw up a rule (or even announce a policy) governing freshening, the Commission kept silent.*

(*Id.*) (emphasis added) (citations omitted.). He concluded that the question now is whether the Commission's finding was supported by substantial weight under the Administrative Procedure Act. 5 U.S.C. § 706(2)(E). (*Id.*).

Judge Easterbrook emphasized that while the ALJ found the testimony of each of the Petitioners to be credible, including their denials of any prearrangement, the Commission gave no reason for disbelieving them other than the Commission's "a priori belief that symmetrical trades must be prearranged," (App. B at 31b), the very position rejected in *Stoller*. "That circular approach is some distance from substantial evidence." (*Id.*). According to Judge Easterbrook, the ALJ's credibility findings in favor of Petitioners were entitled to weight under the substantial evidence test. (*Id.*).

The dissent also noted that other traders testified that they could have participated in the trades if they so chose and that few traders participated in the market at the time of the subject trades because of the risks involved. (App. B at 32b). This evidence, he concluded, was incompatible with a conclusion of prearrangement. (*Id.*). All of the testimony (other than the Division's discredited witness Rooney) favored Petitioners from which Judge Easterbrook concluded that there was no other evidence to support the Commission's findings. (*Id.*). In particular, there was no evidence presented at the hearing that there had been a private arrangement by the Petitioners to engage in the subject trades. (*Id.* at 32b-33b). In fact, the evidence showed that other traders could have participated in the subject trades, recordation mistakes were not unusual and could not imply misconduct, and no evidence was presented to support a conclusion that the pattern of the subject trades was somehow unusual. (*Id.*). This evidence, Judge Easterbrook emphasized, fell far short of "substantial evidence" required to

support the Commission's opinion, and that outcome of this case does "nothing but impose needless costs on all participants in futures markets" by "inflicting a random penalty" on a legitimate trading practice. (*Id.* at 35b, 37b-38b).

D. The Jurisdiction Of This Court

Petitioners seek to invoke the Court's jurisdiction to review the decision of the Seventh Circuit pursuant to 28 U.S.C. § 1254(1). Petitioners argued to the Commission and again to the Seventh Circuit that the Commission's opinion was contrary to the substantial evidence presented at the hearing and effectively created a new rule by making illegal the legitimate practice of freshening in a commodity futures market. This case is ripe for review because the Seventh Circuit opinion conflicts with the decision of the Court in *Allentown* regarding the proper deference to be given an administrative agency when reviewing the substantial weight of the evidence and the Seventh Circuit's opinion creates a conflict of law between the two circuits that decide almost all the significant commodity cases -- the Second and Seventh Circuits.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

I. The Supreme Court Should Grant The Writ Of Certiorari Because The Seventh Circuit Opinion Conflicts With The Court's Decision In *Allentown* Regarding The Deference Given To An Administrative Agency's Decision And It Is Not Supported By The Substantial Weight Of The Evidence.

The Panel Opinion effectively holds that the analysis applied by the Commission and the result reached have a "rational basis and are supported by substantial evidence." 5 U.S.C. § 706; (App. B at 2b). Contrary to the

Panel's conclusion, the substantial evidence test of the Administrative Procedure Act (the "APA"), is not met. In fact, the decision of the Panel conflicts with the Court's decision in *Allentown Mack Sales & Service, Inc. v. National Labor Relations Board*, 522 U.S. 359, 118 S. Ct. 818 (1998), as to the deference to be given an administrative agency's decision. Because the decision in *Elliott* conflicts with the holding in *Allentown*, a writ of certiorari should be granted to resolve this issue. Sup. Ct. R. 10(c).

Section 706 of the APA requires reversal of an agency decision that is not supported by a substantial weight of the evidence. 5 U.S.C. § 706(2)(E). In applying this standard, courts must assume some responsibility for the reasonableness and fairness of agency decisions. *Universal Camera Corp. v. National Labor Relations Board*, 340 U.S. 474, 490, 71 S. Ct. 456, 466 (1951). As explained in *Allentown*, this standard requires the Court to determine whether on the record presented, "it would have been possible for a reasonable jury to reach the . . . [agency's] conclusion." 522 U.S. at 366-67, 118 S. Ct. at 823. Thus, the question presented for review is whether, on the evidence presented to the Commission, a reasonable jury could have found that Petitioners engaged in prearranged and wash trading. Under the instant facts, no reasonable jury could have made such a finding. Stated differently, the only way to reach the Panel's conclusion is to disregard the requirements of *Allentown*.

In *Allentown*, the Court reversed the Court of Appeals for the District of Columbia which affirmed a determination by the National Labor Relations Board ("NLRB") that the employer had committed an unfair labor practice by polling employees concerning union support without a good-faith reasonable doubt as to the union's majority support by the company employees. In rejecting the factual

findings and holding of the NLRB and circuit court, the Court held that the Board's determination that the employer lacked such a doubt was not supported by substantial evidence on the record as a whole. 522 U.S. at 380, 118 S. Ct. at 829. As stated by Mr. Justice Scalia,

> Because reasoned decisionmaking demands it, and because the systemic consequences of any other approach are unacceptable, the Board must be required to apply in fact the clearly understood legal standards that it enunciates in principle, such as good-faith reasonable doubt and preponderance of the evidence. Reviewing courts are entitled to take those standards to mean what they say, and to conduct substantial-evidence review on that basis. Even the most consistent and hence predictable Board departure from proper application of those standards will not alter the legal rule by which the agency's factfinding is to be judged.

Id. at 376-77, 118 S. Ct. at 828. In the Court's analysis, Mr. Justice Scalia rejected the determination of the NLRB and court of appeals which had discounted the testimony of three witnesses who arguably supported the employer's defense. *Id.* at 379-80, 118 S. Ct. at 829. The Court emphasized that while the "substantial evidence" test gives the agency the benefit of the doubt, it is an "objective test" and "there is no room within it for deference to an agency's eccentric view of what a reasonable factfinder ought to demand." *Id.* at 377, 118 S. Ct. at 828; *see also Universal Camera*, 340 U.S. at 490, 71 S. Ct. at 466.

In the present case, no "reasoned decisionmaking" by the CFTC took place. Under the "objective" substantial evidence test, the Commission did not show that the "fresh-

ening" trades at issue constituted improper wash sales prohibited by the Commodities Exchange Act. The testimony of the Division's only witness, Hugh Rooney, was, as Judge Easterbrook stated, "junk science." (App. at 29b). Clearly, the Panel's deference to the purported expertise of the Commission does not require that a reviewing court lend a blind eye to the nature of the evidence presented. The Panel derides the Commission's expert witness and his conclusions as unreliable, yet it defers to the Commission by reaching the same conclusions on the same evidence. In fact, the Panel readily admits the "seeming illogic of rejecting . . . [the expert's] inference on the one hand . . . while endorsing the Commission's on the other . . . ." (App. B at 19b). This wholly contradictory position results in part from the failure to apply properly the substantial weight of the evidence test.

Without Rooney's testimony to support the Commission's conclusion, an objective review of the evidence reveals the "agency's eccentric view of what a reasonable factfinder ought to demand." The evidence for Petitioners was overwhelming. The four Petitioners each denied under oath any wrongdoing and were found by the ALJ, the only person to view their demeanor, to be credible. In fact, the Division stipulated that Petitioners have "high integrity and have . . . excellent reputation[s] on the floor" as traders. (App. D at 8d). While an agency can disagree with an ALJ's credibility determination, it must do so only upon good reason. *Universal Camera*, 340 U.S. at 496-97, 71 S. Ct. at 467-68, 469. Here, none exists. The only basis relied upon by the Commission and the Panel is the circular pattern of trading, a pattern testimony established would be expected during the delivery cycle.

The testimony of nine other witnesses on behalf of Petitioners, whose testimony went largely unrebutted, es-

tablished that Petitioners made the trades by open outcry and other traders could have participated in the trades if they so chose. As Judge Easterbrook underscored, "[i]f traders perpetrate hugger-mugger to avoid scrutiny by their peers and thus prevent competitive bids from being made, then it is sound to infer that the fix is in that that the real price and quantity were set off the floor." (App. B at 31b-32b). In this case, however, all the evidence suggests the bids were competitively executed and other traders could have participated had they wanted.

The testimony also established that some audit trail irregularity was a common occurrence. This evidence does not show that the recordation errors were unusual or indicative of prearrangement. Both the Commission and Panel are silent on this matter. Indeed, as Justice Easterbrook states, "[i]f the number and kind of irregularities were normal for this type of trading, then there is no basis for an inference that hanky-panky occurred." (App. at 32b-33b).

The Commission and the Panel are left with the pattern of the subject trades to support the inference that Petitioners engaged in prearranged trading. However, the record contains no evidence upon which to base this conclusion. There is no evidence of what a pattern of legal regular trading would look like in a constricted market in a delivery month. Moreover, *Stoller v. Commodity Futures Trading Commission*, 834 F.2d 262 (2d Cir. 1987) (App. E) (discussed infra Part II) holds that an inference of illegal trading cannot be inferred from the pattern of the trades alone.

The detailed findings of fact and conclusions of law by the ALJ in favor of Petitioners demonstrated that the Commission did not have substantial evidence to reverse the dismissal-of-charges ruling by the ALJ. Moreover, the

Commission's 3-1 decision here was compromised in this case because the only Commissioner who had traded commodity futures contracts -- Commissioner Tull -- concluded that the evidence of freshening at issue here was not improper.

Justice Scalia's recognition in *Allentown* that the substantial evidence test, as an objective test, does not require deference to an agency's eccentric view of what a reasonable factfinder ought to demand applies here. Despite a four day hearing by a respected ALJ, the Commission cloaks its eccentric application of the evidence and conclusion under the disguise of technical expertise. As Judge Easterbrook concluded, the Commission failed to present statistical analysis of freshening trades other than the ones at issue. (App. at 33b-35b). By failing to present such evidence, the Commission did not meet its burden, and the ALJ so properly ruled. (*Id.*).

In sum, under *Allentown*, the Commission and the Panel has set forth no "principled reason" for disregarding the overwhelming evidence in favor of Petitioners. (App. B at 31b). The Commission and the Panel failed to properly evaluate the entire record, including the ALJ's determination of the credibility of the witnesses, the reasonable inferences drawn therefrom, and other relevant circumstances to determine whether the Commission was justified and acted reasonably in concluding that Petitioners engaged in prearranged and wash trading.

II. The Supreme Court Should Grant The Writ Of Certiorari Because The Seventh Circuit Opinion Regarding "Freshening" And "Wash Sales" Conflicts With The Second Circuit's Decision In *Stoller*, Thereby Creating Uncertainty In The Commodity Futures Markets

The Court should also grant the writ of certiorari to address the conflict created by Seventh Circuit's decision in *Elliott* and the Second Circuit's decision in *Stoller v. CFTC*, 834 F.2d 262 (2d Cir. 1987) (App. E) Sup. Ct. R. 10(a). The conflict between these two courts of appeal, the two primary circuits encompassing the commodity futures markets, should be resolved because this conflict creates uncertainty in these markets regarding the practices of "freshening" and "wash sales" and it results in a chilling effect on those markets.

In *Stoller*, the Commission charged a commodities account executive with engaging in "wash sales" in violation of Section 4c(a)(A) of the Commodities Exchange Act on the New York Mercantile Exchange relating to potato future contracts in 1976. (App. E at 1e-2e). The market price of potato futures was artificially depressed at that time by an illegal conspiracy. (*Id.* at 3e). Stoller placed orders to sell his existing potato futures and to replace them with newly-acquired contracts. Stoller then moved for summary judgment claiming his transactions to "get behind the delivery line" were not wash sales. (*Id.* at 4e). The motion was granted. (*Id.*). The Commission reversed the ALJ. (*Id.* at 5e).

The Second Circuit reversed the decision of the Commission holding that the absence of adequate prior notice of the CFTC's construction of the term "wash sales" constituted an incurable defect. (App. E at 5e-6e). The court of appeals held that Stoller's transactions, though de-

signed to minimize risk, were found by the ALJ to have a legitimate market purpose. (*Id.* at 9e). The Second Circuit concluded that the Commission must give notice of its construction of the Act. (*Id.* at 11e). Because the Commission did not adequately apprise the public, Stoller was not held liable for his alleged violations. (*Id.* at 11e).

Stoller is on point. Here, as in *Stoller*, the Panel Opinion extolled the virtues of "getting to the back of the delivery line." Specifically, in *Elliott*, the Panel Opinion acknowledged the financial benefits of freshening to the commodities markets. In particular, the Panel stated: (1) "[f]reshening is a legitimate trading strategy"; (2) freshening is a legitimate means to decrease or delay the physical delivery of a cash commodity; and (3) freshening helps "assure that longs desiring delivery will be high on the final lists of eligible assignees of delivery notices." (App. B at 3b, n.2) (citations omitted). This trading strategy provides needed liquidity (conversion of assets to cash) in the commodity futures markets. As the CBOT stated in its amicus brief to the Seventh Circuit, "trade freshening adds liquidity to the efficiency of the market by improving competitive conditions because such floor traders may be willing to take positions for less reward than large commercial participants." (Amicus Brief of the Chicago Board of Trade at 7) (hereafter "CBOT Amicus Brief").

But unlike the Panel Opinion, the Second Circuit recognized the significance of this trading strategy by holding that the CFTC could not make this trading tactic illegal retroactively. (App. E at 8e). As the *Stoller* court explained:

> An agency is free, of course, to interpret its governing statue case by case through adjudicatory proceedings rather than by rulemaking. In so doing, it may "announc[e] and apply[] a new standard of

> conduct." However, if the Commission suddenly changes its view . . . with respect to what transactions are "bona fide trading transactions," it may not charge a knowing violation of that revised standard and thereby cause undue prejudice to a litigant who may have relied on the agency's prior policy or interpretation.

(*Id.*) (citations omitted).

As Judge Easterbrook emphasized, the Commission has ignored the dictates of *Stoller* thirteen years later and again found the legitimate trading practice of delaying delivery of a commodity to constitute illegal prearranged and wash sales. (App. B at 28b). Accordingly, the Commission's decision here, and the Seventh Circuit's affirmance of that agency decision, results in the improper imposition of a retroactive rule banning freshening without due process of law in violation of *Stoller*.

The Court should not countenance the Commission's failure to act post-*Stoller* regarding "freshening" and "wash sales." As the Court has recognized, "Before transactions otherwise legal can be outlawed or denied their usual business consequences, they must fall under the ban of some standard of conduct proscribed by an agency of government authorized to prescribe such standards -- either the courts or Congress or an agency to which Congress has delegated its authority." *SEC v. Chenery Corp.*, 318 U.S. 80, 92-93, 63 S. Ct. 454, 461 (1943). "It is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress . . . [and] administrative rules will not be construed to have retroactive effect unless their language requires this result." *Bowen v. Georgetown University Hospital*, 488 U.S. 204, 208, 109 S. Ct. 468, 471 (1988). Here, the Commission failed to establish a rule when directed by the

Stoller court to do so. The Commission should not be allowed to flout the law and then prosecute commodity traders for what it admits is a lawful practice.

The Panel Opinion has adverse consequences for the commodities futures markets and the nation's economy. In its amicus brief to the Seventh Circuit, the CBOT explained that its "interest in this matter is the potential impact which the court's decision might have on the liquidity and consequent effectiveness of the Exchange's futures markets." (CBOT Amicus Brief at 2). The CBOT expressed concern that a ban on this legitimate trading practice -- a practice which is beneficial to the proper functioning of the futures markets -- would create a market in which no trader would be willing to stay in the market during a delivery cycle. (*Id.*). Petitioners submit that the position of the CBOT, the nation's leading self-regulating commodities futures organization, should be given substantial weight on this issue.

The evidence presented at the hearing also supports both Petitioners' and the CBOT's positions. Dr. Scott Irwin, then an Associate Professor of Agricultural Economics at The Ohio State University testified:

> The practice of trading to delay delivery improves liquidity and competitive conditions during expiration periods. This in turn helps to speed the convergence of futures and cash prices and enhance the accurate discovery of market prices. There is a strong economic argument that the practice of trade freshening plays a positive role in the delivery process of agricultural futures contracts.

(CBOT Amicus Brief at 6). The ALJ recognized that Professor Irwin "described the illiquidity of agricultural futures contracts as they approach expiration and gave his opinion

that traders who participate during the delivery cycle add a beneficial competitive force by creating liquidity during this period." (*Id.*).

In short, the outcome of this case has significant ramifications for the four petitioner commodity traders, the agricultural commodity markets, and the liquidity of those markets during the delivery cycle. Because of the conflict between the Seventh and Second Circuits, the Court should grant Petitioners' writ of certiorari.

CONCLUSION

For all the foregoing reasons, Petitioners Wayne I. Elliott, Francis Maritote, J. Brian Schaer and Jonathan A. Sion respectfully request that the Court grant their petition for writ of certiorari.

Respectfully submitted,

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